



# THE NEW DC NONPROFIT CODE

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NOVEMBER 30, 2011

# DC Nonprofit Code

- Last updated in 1962.
- The new law completely amends and restates the code.
- Applies to most nonprofits beginning January 1, 2012.
- Based on the third edition of the Model Nonprofit Corporation Act.

# Mandatory Provisions in Articles of Incorporation

- The articles of incorporation must set forth:
  - A name for the nonprofit;
  - That it is incorporated as a nonprofit under the DC Nonprofit Code;
  - The name and address of each incorporator;
  - Initial registered agent; and
  - Whether the corporation will have members.

# Membership Organizations

- ◉ Does the nonprofit have members?
  - Members are intended to serve a role similar to that of shareholders.
  - They are typically given the right to elect all or some of the directors.
  - They also have the right to approve major corporate transactions such as mergers or dissolutions.
  - Sometimes members are given no right to participate in the governance of the nonprofit.
  - Sometimes the nonprofit no longer follows the membership provisions in the governing documents and simply switches to a self-perpetuating Board.

# Membership Organizations

- ① Under the old law membership rights were not spelled out in great detail.
- ① “Members shall not be entitled to vote except as ...conferred by the articles of incorporation.”
- ① The new Nonprofit Code provides for much more structure with respect to membership rights.

# Membership Organizations

- Under the new Nonprofit Code, members must be given a right to participate in the governance of the organization.
- If a “member” has no rights, then the nonprofit is not a membership organization under the Nonprofit Code.
- An individual must consent to be a member – either explicitly or implicitly by accepting benefits that the individual knows are only available to members.
- Generally, members are not liable for the debts of the organization.

# Who is a Member?

- ⦿ Typically, members are defined in very non-specific terms – “all individuals who support our mission” is typical language.
- ⦿ Sometimes members are defined as “the members of the Board of Directors.”
- ⦿ People may be considered to be members without their knowledge. (i.e., all donors are treated as members.)

# Who is a Member?

- The Nonprofit Code requires the nonprofit to maintain a current membership list.
- The nonprofit must maintain a “record of its members, in a form that permits preparation of a list of names and addresses of all members, in alphabetical order, by class, showing the number of votes each member is entitled to cast.”
- A member is entitled to inspect the membership list upon giving the nonprofit five days’ notice.



# Who is a Member?

- ⦿ The nonprofit must develop specific criteria for determining who is a member.
- ⦿ For example, have person apply to be a member or pay dues.
- ⦿ If a nonprofit wishes to extend membership to “all individuals supporting the mission of the organization,” the organization should treat such provision as simply allowing such people to apply for membership, and not as actually conferring membership benefits.

# Annual Meeting

- ⦿ Typically, a membership organization has an annual meeting. Directors are elected at annual meeting.
- ⦿ Failure to hold an annual meeting does not effect the validity of any corporate transaction.
- ⦿ The Board or a person designated in the governing documents may call a special meeting. Members may call a special meeting.

# Member Notice

- Notice must be given for every meeting. Unless otherwise provided, notice must be given at least 10 and not more than 60 days prior.
- Nonprofit can call special meeting in addition to annual meeting. Members can also call a special meeting. Notice of special meeting must explain the purpose for the meeting.
- Notice typically must be given in the form of a record –information inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in tangible form. Otherwise, the bylaws may specify how notice is given -email, regular mail, fax, etc.

# Books and Records

- Nonprofit organization must maintain at principal office
  - Articles of Incorporation and Bylaws
  - Minutes of Board and Committee meetings and accounting records for past 3 years
  - Communications to the membership for past 3 years
  - Names, business addresses of officers and directors
  - Most recent biennial report
  - IRS Form 990 for 3 years; Form 1023; and IRS determination letter (not required by DC law, but by IRS)
  - Names and addresses of members
- Members have a right to inspect these records.

# Record Date

- ⦿ The record date is the date on which to determine who is a member eligible to vote.
- ⦿ The governing documents must specify the manner for determining the record date. The record date may not be more than 70 days before the meeting.

# Conduct of Meeting

- The articles or bylaws should specify who is the presiding officer at the meeting.
- Unless otherwise provided in the governing documents proxy voting is allowed.
- Voting agreements between members are enforceable. They can be revoked by executing new agreement.

# Conduct of Meeting

- ④ The governing documents specify the quorum requirements. No minimum quorum.
- ④ Often the quorum is set very low to make sure that the meeting can be held.
- ④ Directors are typically elected by a plurality of votes. Other matters are typically decided by a majority of the quorum.
- ④ The governing documents may provide that special meetings be held by means of the Internet or other technology like Skype. Members must be able to read or hear the proceedings, vote on matters and make comments.

# Action in Lieu of Meeting

- ⦿ Unless governing documents say no, the members may act by ballot.
  - The ballot must set forth each proposal, the number of responses needed to meet the quorum requirements, the percentage of approvals necessary to approve each matter, and the date by which to return the ballot.
  - The approval of any action other than the election of directors is valid if the number of votes cast at least equals the quorum requirement for a meeting and the number of approvals at least equals the number of approvals that would be required at a meeting.



# Board of Directors

- Must be at least three directors.
- A director's term cannot exceed five years. Two or three-year terms are typical.
- Directors may be re-elected. Best practice is to have term limits, although this can be a challenge for small nonprofits.
- Typically have classes of directors with staggered terms.
- Directors are elected by the Board, unless elected by members.

# Board of Directors - Terminology

- ⦿ Larger nonprofits – the CEO is typically referred to as CEO or President and may be a member of the Board. The chief officer of the Board is referred to as the Chair.
- ⦿ Smaller nonprofits – the CEO is more commonly referred to as an Executive Director (or sometimes CEO). CEO is not a member of the Board. The chief officer of the Board is referred to as the President.

# Board of Directors - Removal

- Directors elected by Board can be removed by the Board, with or without cause.
- Directors elected by the members can be removed by the members, with or without cause.
- For membership organizations, the Board may remove a directors only if the director:
  - Has been declared of unsound mind;
  - Has been convicted of a felony;
  - Has been found by final order to have breached duties;
  - Has missed the number of meetings specified in the governing documents at the beginning of the term;
  - No longer satisfies the requirements for being a director specified in the governing documents at the beginning of term; or
  - Any other reason specified in the bylaws.

# Board of Directors - Vacancies

- ⦿ Board may fill vacancies of non-member organizations.
- ⦿ For membership organization, unless the governing documents provide otherwise, the members must be given the exclusive opportunity to fill the vacancy for the first three months.
- ⦿ The Board may fill the vacancy if members do not.
- ⦿ A vacancy caused by a director who is appointed by a specified individual or entity can only be replaced by the individual or entity that made the initial appointment.

# Board of Directors - Meetings

- ⦿ No requirement to hold an annual meeting.
- ⦿ Meetings may be held via conference equipment and Board may act by unanimous consent unless governing documents provide otherwise.
- ⦿ Regular meetings may be set by governing documents or by resolution of the Board.
- ⦿ Special meetings may be called by Chair, highest ranking officer or 20% of the directors, unless otherwise provided.

# Board of Directors - Meeting

- Quorum set in governing documents – must at least equal the greater of 2 directors or 1/3<sup>rd</sup> of Board. If no quorum set in bylaws – then 50%.
- Affirmative vote of the quorum is sufficient unless higher number specifically required.
- In the case of the Board of Directors, proxy voting or ballot voting is not allowed by law and not acceptable substitute for failure to meet quorum requirements.
- Many alternatives to proxy/ballot voting— executive committee, conference call, unanimous consent.

# Board Meetings - Notice

- Generally, at least 2 days' notice of a special meeting must be given unless bylaws say otherwise. Notice need not explain the purpose of meeting.
- Notice typically must be given in writing or electronically if it is retrievable in tangible form. Otherwise, the bylaws may specify how notice is given -email, regular mail, fax, etc.

# Officers

- ⦿ Under the Nonprofit Code, officers may be elected or appointed in accordance with the bylaws.
- ⦿ They may be removed with or without cause by a vote of the Board of Directors.
- ⦿ It does not require the vote of a majority of the directors then in office to elect or remove an officer, although many consider it a best practice to require a majority of the whole.



# Officers

- Under Nonprofit Code, there must be two officers:
  - one responsible for the management of the organization, and
  - one responsible for its financial affairs.
  - Secretary and President/Chair may be same person.
- The governing documents must assign to one of the officers the responsibility for preparing the minutes of the meetings of the board of directors and for maintaining and authenticating the minutes and governing documents.

# Administrative Officers

- Nonprofit bylaws usually have clear definition of Board officers – Chair, Vice Chair, Secretary & Treasurer.
- However, they are not often clear as to who is an administrative officer – such as the CEO and CFO.
- Language in nonprofit bylaws often suggest that the Chair is the chief management officer, while in other contexts, such as for purposes of IRS regulations, it is the executive director.
- Role of treasurer vs. director of finance is often confused. Who is the CFO?
- Given the new fiduciary duties and indemnification provisions, it is important to clarify who is an officer.

# Administrative Officers

- The chief executive, whether called the executive director, the CEO or the President, is responsible for overseeing the day-to day operations of the organization.
- The chief executive is responsible for:
  - Carrying out day-to-day mission activities.
  - Hiring, supervising and firing personnel.
  - Ensuring that the organization's policies and procedures are followed.

# Administrative Officer

- Ensuring that the organization expends its funds prudently in accordance with the budget and good management practices.
- Maintaining accurate records of the organization's activities.
- Regularly reporting to Board the status of organization, including major events that could have a material effect on the organization.

# Administrative Officers

- In the case of an all-volunteer or small organization, the CFO may be a member of the Board. Otherwise, a member of senior management is responsible for these duties. (Cannot be the CEO.)
- The Chief Financial Officer ensures that:
  - The books and records of the organization's financial activities are kept in accordance with generally accepted accounting principles.

# Administrative Officers

- The organization has a system of financial controls to protect its assets and that they are being followed.
- Employees are compensated on time.
- Accounts are paid in on time.
- Tax filings are made & taxes are transmitted to the appropriate government authority.
- The Chief Executive and the Board are regularly informed of the financial status of the organization.

# Committees & Designated Bodies

- ④ The Nonprofit Code provides for the appointment of Board committees that may be authorized to carry out responsibilities of the Board.
- ④ Since committees can act in lieu of the Board, only directors may serve on Board committees.
- ④ If non-Board members serve on a committee is must qualify as either a designated body or advisory committee.
- ④ A committee may consist of one director.

# Committees & Designated Bodies

- ⦿ Creation of the committee and the appointment of its members must be approved by the greater of:
  - the majority of the directors then in office; or
  - a quorum authorized to vote on the matter.
- ⦿ The Board cannot delegate to a committee the authority to:
  - Authorize distributions;
  - Fill vacancies on the board or a committee;
  - Adopt, amend or repeal the bylaws; or
  - Propose matters to be voted on by the members.



# Advisory Committees

- Board of Directors may appoint advisory committees.
- Advisory committee may be made up of non-directors.
- Under the Nonprofit Code, advisory committees cannot be given the authority to exercise any of the powers of the Board.
- Advisory committee can have the authority to exercise the duties of officers, employees or agents.
- Common examples of such committees carrying out non-Board functions:
  - Fundraising committee
  - Public relations committee
  - Program committee

# Designated Bodies

- A designated body is a body consisting of individuals (not all of whom need be directors) or entities that have the authority to exercise some, but not all of the powers of the Board or members.
- To the extent such powers are invested in a designated body, the Board is relieved of all legal responsibility with respect to such powers.
- To the extent a designated body has the authority of the Board, it stands in the shoes of the Board with respect to the Nonprofit Code, with respect to notice, indemnification, etc.

# Designated Bodies

- ⦿ The local bar is responsible for overseeing the practice of law in the jurisdiction. It oversees the licensing and discipline of members, sets the CLE requirements and dues, and engages in other activities.
- ⦿ The power to discipline attorneys is vested in a committee of bar members that is responsible for reprimanding, suspending or disbarring members. Per the articles of incorporation, the Bar's board of governors does not have the authority to review or reverse any of the committee's decisions. The disciplinary committee is a designated body and the board of governors cannot be held liable for its decisions.

# Designated Bodies

- Other possible use of designated body cited by drafters of model act:
  - The Board can appoint a compensation committee composed of members of the Board and non-Board members. The compensation committee would be authorized to conduct an annual review of the CEO's performance with input from the Board. The committee would also decide on any changes in the CEO's total compensation, both in relation to the marketplace (per IRS regulations) and within the total amounts approved by the Board in the Corporation's annual budget.

# Issues That Need to be Discussed

- Often Board members do not have expertise to carry out certain functions, and individuals with expertise do not have time to serve as directors. Therefore, many nonprofits have non-Board members on committees.
- Recruiting non-Board members as committee members also spreads the work, so that the Board has more help.
- Committees are often a way to keep people such as major donors and former Board members engaged, and can help identify potential Board members

# Issues That Need to be Discussed

- Most did not think current Nonprofit Code as prohibiting non-Board members on committees. Common practice was to make sure majority of the committee were directors.
- Commentary on the model act makes clear that only Board members may serve on committees.
- In most cases, a committee's actions are approved by the Board, but not always. (Audit and compensation committees typical exceptions.)

# Possible Options

- For committees not dealing with core Board activities no issue:
- Other committees membership must be limited to Board members:
  - Finance, Compensation, Audit, Executive, committees.
  - Note: the CEO/Executive Director is a non-Board member unless the bylaws specifically provide that ED is a member of the Board.
- Nonprofit could make these advisory committees and include non-Board members, but this may be a problem if need committee to act.
- No language in new Code allowing or prohibiting non-directors serving as non-voting members on Board committees.

# Director's Standard of Conduct

- ⦿ Directors must act in good faith and in a manner the director reasonably believes to be in the best interests of the nonprofit.
- ⦿ The director must act with the care that a person in a like position would reasonably believe appropriate under the circumstances.
- ⦿ A director must disclose to the other board members all material information not already known to them, unless the director has a legally enforceable responsibility of confidentiality.
- ⦿ A director may rely on committees acting within the scope of their charter, employees acting within the scope of their authority, and professionals such as attorneys or CPA's unless there is reason not to rely.



# Officer's Standard of Conduct

- Officers are subject to the same standard of care as directors.
- In addition, an officer has a duty to provide the Board with all the information the officer has learned while performing his or her duties that is material to the Board in carrying out its responsibilities.
- An officer also has an obligation to inform a superior officer or the Board if the officer believes that another person has or is likely to engage in a breach of duty to the nonprofit or in a material violation of the law involving the nonprofit.

# Liability of Directors

- ◉ Directors of charitable organizations are not liable for any act or failure to act, except liability for:
  - The amount of a financial benefit received by the director and to which the director is not entitled;
  - An intentional infliction of harm;
  - An unlawful distribution of the nonprofit's assets; or
  - An intentional violation of criminal law.

# Liability of Directors

- Volunteers for charitable organizations are immune from civil liability except for willful misconduct, criminal conduct, actions taken in bad faith, or if the volunteer receives an improper benefit.
- In order for the immunity to apply , either:
  - The charity has liability insurance equal to \$200,000 per person and \$500,000 in the aggregate, or
  - Its annual total functional expenses, exclusive of grants and allocations, is less than \$100,000
- Employee's liability in the same circumstances is limited to his or her prior 12 months' compensation.
- This is the same as current law.

# Loans to Officers & Directors

- A nonprofit may not loan money or guarantee a loan or an officer or director, except for:
  - A loan to help pay premiums on a life insurance policy if the loan is secured by the cash value of the policy;
  - A loan to an officer for relocation expenses; or
  - A loan to an officer that is secured by the officer's principal residence.
- ⦿ This is a change from current law which had an absolute prohibition on loans to officers or directors.
- ⦿ Common for bylaws to prohibit loans.
- ⦿ Question whether a nonprofit should change it.

# Conflict of Interest

- Conflict of Interest is a transaction involving an officer or director and another entity for which such officer or director holds a similar position or has a financial interest.
- A conflict of interest transaction may be void or voidable unless:
  - The material facts are disclosed or are known to the Board, and a majority of the disinterested directors approves the transaction;
  - The facts are disclosed/known to the members and they approve the transaction; or
  - The transaction is fair to the nonprofit at the time it is approved or ratified by the Board.
- This is not the IRS standard which is much stricter.

# Indemnification

- The Nonprofit Code makes substantial revisions to the indemnification provisions under prior law.
- The new Nonprofit Code provides for:
  - Mandatory indemnification
  - Permissive indemnification
  - Court ordered indemnification
  - Indemnification of officers

# Mandatory Indemnification

- The Corporation must indemnify any director to the extent the director was successful in the defense of any proceeding to which the director was a party against reasonable expenses incurred by the director in connection with the proceeding.

# Permissive Indemnification

- Nonprofit may also indemnify director if director:
  - Acted in good faith;
  - Reasonably believed:
    - In the case of official conduct, that the conduct was in the best interests of the nonprofit; and
    - In all other cases, that the conduct was at least not opposed to the best interests of the nonprofit;
  - In the case of any criminal proceeding, had no reasonable cause to believe the conduct was unlawful; and



# Permissive Indemnification

- If the articles of incorporation so provide, the nonprofit may provide additional indemnification to a director for liability to a third party that does not involve:
  - the unlawful distribution of the nonprofit's assets;
  - receipt of a financial benefit to which the director is not entitled;
  - an intentional infliction of harm on the nonprofit, or
  - an intentional violation of criminal law.

# Determination of Indemnification

- ◎ The termination of a proceeding by a judgment, settlement agreement, conviction or upon a plea of nolo contendere is not determinative that the director did not meet the standard of conduct.
- ◎ Unless ordered by a court, the nonprofit may not indemnify a director in connection with:
  - a proceeding by or in the right of the nonprofit unless for expenses reasonably incurred because of the proceeding; or
  - with the receipt of a financial benefit to which the director is not entitled.

# Determination of Indemnification

- Any indemnification must be specifically authorized by a vote of the Board of Directors.
- The determination and authorization may be made:
  - By a majority vote of the disinterested directors,
  - A committee of disinterested directors; or
  - If not at least two disinterested directors, by special legal counsel appointed by Board.
- ◉ The Board of Directors may advance funds to pay for reasonable expenses.

# Indemnification of Officers

- Officers are entitled to mandatory indemnification and may receive additional indemnification in the same manner as directors.
- If an officer is also not a director, the nonprofit may provide additional indemnification to the officer, except an officer may not be indemnified for:
  - a proceeding by or in the right of the nonprofit unless for expenses reasonably incurred because of proceeding;
  - receipt of financial benefit to which the officer is not entitled;
  - an intentional infliction of harm on the nonprofit, or
  - an intentional violation of criminal law.

# Amendment of Bylaws

- Members may amend bylaws, unless the governing documents provide otherwise.
- The Board may amend the bylaws, unless the governing documents provide otherwise.
- If nonprofit is a membership organization, the board may not amend the bylaws without the members' consent if the amendment would change the rights of some or all of the members, relate to the termination or suspension of membership rights, relate to the removal of a director elected by the members or would levy dues or assessments on the members.

# Registered Agents

- Biennial reports will now be due April 1<sup>st</sup>.
- Nonprofit may use a commercial or individual registered agent.
- If noncommercial agent, then the person must be:
  - An officer or director of the nonprofit;
  - An individual or entity that serves in the District as an agent for service of process; or
  - An attorney licensed in DC and with an office in DC.
- Registered agent no longer must be resident of DC.

# Questions?

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